STATE OF MICHIGAN
JOHN ENGLER
GOVERNOR
OFFICE OF FINANCIAL AND INSURANCE SERVICES
DEPARTMENT OF CONSUMER & INDUSTRY SERVICES
RONALD M. BASSO, ACTING DIRECTOR
FRANK M. FITZGERALD
COMMISSIONER

DATE: August 8, 2002

LETTER NO.: 2002-CU-08

TO: The Board of Directors and Management of Michigan State-Chartered Credit Unions

SUBJECT: 2002 Mid-Year Financial Results

OFIS compiles call report information to monitor Michigan State-Chartered Credit Unions, both individually, and in the aggregate. The purpose of this letter is to share some overall industry trends and highlight certain areas of particular concern based on the June 30, 2002 call report filings.

Summary

Overall, Michigan's 282 State-Chartered Credit Unions remain in sound financial condition and continue to provide quality products and services to their members. Credit union membership is over 2.6 million, and total assets now exceed $16 billion. Loans grew at a relatively strong 7.8% annual rate, to $9.7 billion, in the first half of 2002.

Many credit unions, however, are experiencing rapid asset growth, high loan delinquency and charge-offs, low or negative net earnings, and declining net worth ratios. Areas of regulatory concern identified in our analysis of the June 30, 2002 call report information include the following:

Earnings Deterioration

There are 38 credit unions reporting a year-to-date net loss at June 30, 2002, more than double the number reporting losses one year ago. Another 29 credit unions report very weak Return on Average Assets ratios of 0.20% or less. Forty-nine credit unions report ROA declines of more than 75 basis points in the past 12 months. The annualized aggregate ROA at June 2002 is 0.78%, the lowest level in the past 14 years.

Earnings are a credit union's only source of net worth. Poor earnings performance jeopardizes the long-term viability of an institution, and should be a cause for serious concern to credit union officials.

Net Worth Erosion

The aggregate net worth ratio of Michigan State-Chartered Credit Unions dropped to 11.06% at June 30, 2002, the lowest level reported since 1995. Twenty-eight credit unions report net worth ratios below 8%, and eight had their net worth ratios decline by more than 20% during the first half of 2002.

Asset Quality Concerns
Overall delinquency levels remained relatively stable. Charge-offs, however, became more of a problem in the first six months of 2002. Twenty-five credit unions had an increase in the net charge-off ratio of more than 100 basis points, compared to thirteen recording a similar increase at June 2001. There were 22 credit unions with a net charge-off ratio over 1.5% at June 30, 2002, double the number reporting this level of charge-offs in June 2001.

Investments also remain an area of concern as general economic weakness continues. A number of corporate bond ratings have been downgraded, in some cases very quickly, and several issues are actually in default. Boards and management teams must exercise due diligence, including initial and ongoing credit analysis, to ensure that risks inherent in investment activities are properly managed.

High Asset Growth
The annualized asset growth rate for all Michigan State Chartered Credit Union is 15.5% at June 30, 2002, down slightly from the 17.0% reported at mid-year 2001. Forty-one credit unions report annualized asset growth over 20% during the first half of 2002, compared to 75 at June 2001.

Unplanned or poorly managed growth can cause operational problems and erode earnings and net worth. Boards and management teams should carefully review their credit union's asset growth relative to loan demand and net worth position. The incremental net margin on additional funds acquired should be evaluated by comparing the cost of funds to the return available on safe, liquid investments. Dividend and interest rates paid on member savings should be managed to ensure that growth is controlled and an adequate level of earnings maintained.

Conclusion
Prudent risk management includes identifying and quantifying potential risks and adverse trends timely, and taking appropriate steps to ensure that risks are properly managed. Boards of directors and management teams must monitor the financial condition of their credit union on an ongoing basis to ensure satisfactory performance and safe and sound operations are maintained.

A written plan of action should be developed when adverse trends or financial conditions are identified. This plan of action serves to document your board's awareness of the problem and intended actions to control and correct the adverse conditions.

I hope the information in this letter is helpful in making informed business decisions. Operating a financial institution safely and soundly requires diligence in risk identification, measurement, and management. The stresses evident in the June 2002 statistics highlight the need for application of sound management practices in an increasingly uncertain economic environment.

Sincerely,

Roger W. Little, Deputy Commissioner

Credit Union Division